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No. 06–107

IN THE

Supreme Court of the United States

RICHLIN SECURITY SERVICE COMPANY,
Petitioner

v.

MICHAEL CHERTOFF,
Secretary, Homeland Security
Respondent

On Petition For Writ of Certiorari
from the United States Court of Appeals for the Federal Circuit

BRIEF OF AMICUS CURIAE HUBZONE CONTRACTORS NATIONAL COUNCIL IN SUPPORT OF PETITIONER

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INTEREST OF AMICUS CURIAE

This brief is submitted by the HUBZone Contractors National Council ("HCNC"), a tax-exempt trade association representing the interests of HUBZone certified small business concerns.[1] Historically Underutilized Business Zones ("HUBZones") are areas of historical poverty, both urban and rural. A certified HUBZone contractor must be a small business concern whose principal place of business is in a HUBZone with at least 35% of its employees living in a HUBZone. The Small Business Administration currently certifies over 13,000 small businesses as HUBZone companies.

The Federal Circuit's decision in *Richlin Security Service Company v. Chertoff*, 437 F.3d 1296 (Fed. Cir. 2006) is of interest and concern to HCNC because it will as a general matter preclude many of its HUBZone business members from being made whole on their valid claims under contracts with the Federal Government. HCNC submits that the Federal Circuit's in *Richlin* will have the unintended consequence of decreasing HUBZone business and likely other small business participation in Federal contracting—an outcome exactly opposite to that sought by Congressional small business policy.

Both parties granted written consent to submission of this brief.

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[1] This brief was authored entirely by counsel for HCNC, although Counsel for Petitioner was consulted as to the facts relevant to Argument II. No other person or entity other than the *amicus curiae*, its members, or its counsel made a monetary contribution to the preparation and submission of the brief.

SUMMARY OF ARGUMENT

The Federal Circuit's decision holds Richlin to be merely a "conduit" for payment of back wages and associated taxes and insurance premiums hence not an entity entitled to receive interest on its claim pursuant to the provisions of the Contract Disputes Act, 41 U.S.C. §611. This holding is contrary to the established principle that, for purposes of the Government's contract liability, the prime contractor is the only entity that incurs costs. As the prime contractor is the only entity having "privity" with the government under a government contract, the Federal Circuit's holding thus undermines the principle that allows subcontractors to present "pass-through" claims to the government. Further, the decision conflates "costs incurred" with "costs paid", thereby obviating the accepted meanings of "incurred," whose dictionary definition is "to become liable or subject to" and whose accepted meaning in accounting is that a cost is incurred when it becomes a liability, i.e. when one becomes obligated to pay it. Finally, the Federal Circuit decision is inconsistent with Congressional policy encouraging small businesses to participate in Federal contracting both as prime contractors and as subcontractors. The holding will have a chilling effect on small business participation in government contracting by precluding small business contractors with valid claims from recovering interest on costs they have incurred and are obligated to pay but, pending resolution of their claims, have not been able to pay. In addition, the decision's undermining of the "pass-through" principle will limit the ability of small business subcontractors to obtain vindication of their contract rights through the adjudicatory process.

ARGUMENT

I. THE FEDERAL CIRCUIT'S DECISION UNDERMINES THE PRINCIPLE THAT ALLOWS SUBCONTRACTORS AND OTHERS "SPONSORED BY" THE PRIME CONTRACTOR TO RECOVER COSTS

The Federal Circuit treats as a crucial factor whether it was Richlin itself that was "out" the increased wages or "financed" the increase. *Richlin*, 437 F.3d at 1301. For the purposes of the Government's contract liability, however, the prime contractor is deemed to be the entity that incurs any costs in the performance of the prime contractor's obligations, whether the costs are those of the prime contractor, the prime's employees, or its subcontractors. The Supreme Court enunciated this principle over 60 years ago in *United States v. Blair*, 321 U.S. 730 (1944):

> [The prime contractor] was the only person legally bound to perform his contract with the Government and he had the undoubted right to recover from the Government the contract price . . . [for extra work] whether that work was performed personally or through another. This necessarily implies the right to recover extra costs . . . regardless of whether such costs were incurred . . . personally or through a subcontractor.

Id. at 737.

The Federal Circuit's decision deems Richlin to be merely a "conduit," a status which does "not entitle Richlin to receive interest." *Richlin*, 437 F.3d at 1302. This reasoning is contrary to the principle that prime contractors

can present subcontractor "pass-through" claims and are in fact the *only* entities that can do so because only prime contractors have "privity" with the Government. *See Pneumatic Gun-Carriage and Power Co. v. United States*, 36 Ct. Cl. 71, 89 (1901) ("We think defendant should answer at this time without waiting for plaintiff to first pay damages sustained by the subcontractors . . . ."). *George Leary Construction Co. v. Leary*, 63 Ct. Cl. 206 (1927), articulated the rationale for such claims as follows:

> It is easy to forecast the financial ruin of a Government contractor if the rule is established that . . . [the prime contractor] may not recover amounts due from the Government under contract until he established to the satisfaction of the Government that he has paid his subcontractor all he owes him.

Id. at 222.

The Federal Circuit recognizes "pass-through" cases pursued by prime contractors when the underlying claims were those of subcontractors. *See Transamerica Ins. Corp. v. United States*, 973 F.2d 1572, 1580 (Fed. Cir. 1992) (*overruled on other grounds, Reflectone, Inc. v. Dalton* 60 F.3d 1572 (Fed. Cir. 1995)) (holding prime contractor's letter submitting subcontractor's request for equitable adjustment qualified as "claim" under Contract Disputes Act); *Capital Elec. Co. v. United States*, 729 F.2d 743, 745 (Fed. Cir. 1984) (holding prime contractor entitled to recover damages for extended overhead on behalf of subcontractors); *E.R. Mitchell Construction Co. v. Danzig*, 175 F.3d 1369, 1370 (Fed. Cir. 1999) (holding that burden lies with government to prove that prime contractor not responsible for costs incurred by subcontractor in pass-through suit).

The Federal Circuit's decision in *Richlin* casts into doubt the continued viability of "pass through" claims brought by a prime contractor on behalf of its subcontractors and others not in privity with the Government.

II. THE FEDERAL CIRCUIT'S DECISION CONFLATES "COSTS INCURRED" WITH "COSTS PAID"

The Federal Circuit's decision rests in large part on the assertion that "section 611 [does] not authorize interest on costs never actually *paid* by the contractor." *Richlin*, 437 F.3d at 1302. Therefore, the Federal Circuit held that because Richlin could not pay the back wages before it received the funds from the Immigration and Naturalization Service ("INS"), it was not entitled to receive interest on those amounts. *Id.* The court cites *Raytheon Co. v. White*, 305 F.3d 1354 (Fed. Cir. 2002) as the precedent that justifies this conclusion. *Richlin*, 437 F.3d at 1302. The Federal Circuit erred in its application of *Raytheon* because *Raytheon* held that section 611 does not permit interest to accrue on costs that "were never actually *incurred* by the contractor." *Raytheon*, 305 F.3d at 1365. HCNC submits that the Federal Circuit conflated "incurred" with "paid" and overlooked the significant distinction between the two terms.

Raytheon and its predecessor *Servidone Construction Corp. v. United States*, 931 F.2d 860 (Fed. Cir. 1991) both hold that costs must be incurred before interest is payable. *See Raytheon*, 305 F.3d at 1365 (holding that interest is not payable to contractors who never incur any cost); *Servidone*, 931 F.2d at 862 (equating incurred costs with "amounts . . . found due"). Neither decision even mentions "costs paid" or "payment." Thus, the crucial question is whether Richlin incurred costs when it became liable to its employees at the

Guard II wages, not whether Richlin "actually paid" those costs. A cost is incurred when it becomes a liability. *See* MANOS, GOVERNMENT CONTRACT COSTS & PRICING, 116 (Treatise, West, 2004). Merriam-Webster Dictionary defines "incur" as "to become liable or subject to: bring down upon oneself." Black's Law Dictionary defines it as "to suffer or bring on oneself (a liability or expense)."

Did Richlin incur costs? Richlin was awarded "backpay"[2] in its claim against the INS. The Federal Acquisition Regulation ("FAR") classifies "backpay" as a form of "compensation for personal services." 48 C.F.R. § 31.205-6(h)(1). "Compensation for personal services" is "all remuneration paid currently or accrued in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor." *Id.* at § 31.001. When Richlin agreed with the Department of Labor to waive all defenses, it became liable for these compensation costs, which the Board of Contract Appeals eventually determined to be $636,818.72. *In re Richlin Security Service Company*, BCA Nos. 3034 & 3035, 02-2 BCA ¶31,876 (DOTBCA 2002) ("Richlin VI"); *In re Richlin Security Service Company*, BCA Nos. 3034 & 3035, 03-2 BCA ¶ 32,301 (DOTBCA 2002) ("Richlin VII"). Richlin incurred these costs because it became liable for the wages it owed the employees, and it will suffer significant economic loss if interest is not allowed on those payments, when the government's payment to Richlin is delayed.

The reasoning in *Raytheon* is in fact applicable to this case because there the court approved the principle that "once an amount is found due [in the adjudicatory process], it will be subject to the interest provision of Section 611." *Raytheon*, 305 F.3d at 1366. *Raytheon* also holds that

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[2] Called "back wages" or "underpaid wages" in the opinions below. *See Richlin*, 437 F.3d at 1298.

interest accrues on costs "actually incurred" by the contractor whenever they are incurred. *Raytheon*, 303 F.3d at 1365. Again, *Richlin* incurred costs when it became liable to its employees. It follows, under *Raytheon*, that because *Richlin* incurred costs and those costs were found due on an action against the Government, section 611 is applicable and Richlin can recover interest.

III. THE FEDERAL CIRCUIT'S DECISION WILL HAVE A CHILLING EFFECT ON SMALL BUSINESSES' ABILITY TO PARTICIPATE IN THE ADJUDICATORY PROCESS

The Federal Circuit's decision in *Richlin* will as a general matter preclude many of the HUBZone business members of the HCNC from being made whole on their valid claims under contracts with the Federal Government. Second, and more specifically, HCNC is concerned because the Court's fundamental holding in *Richlin* is a straightforward denial of interest on costs a small business contractor or subcontractor has incurred and *is obligated to pay but has not yet paid*:

> In keeping with the purpose of the statute . . . *the contractor can recover interest only on amounts it actually paid.*

Richlin, 437 F.3d at 1301–02.

The holding will preclude HUBZone contractors and other small businesses with valid claims from recovering interest on costs they have incurred and are obligated to pay *but, pending resolution of their claims, have not been able to pay*. The interest costs on such outstanding obligations can

be very significant, particularly for HUBZone and other small businesses. A small business which cannot recover such costs cannot be made economically whole and therefore will have been denied its right to an equitable adjustment under the Changes or other standard clause of its government contract. *Bruce Construction Corp. v. United States*, 324 F.2d 516 (Ct. Cl. 1963) ("Equitable adjustments . . . are simply corrective measures utilized to keep a contractor whole when the Government modifies a contract.").

Small businesses are "often vulnerable to coercive agency action" and must sometimes turn to the adjudicatory process to obtain vindication of their rights. *Photo Data, Inc. v. Sawyer*, 533 F. Supp. 348, 351 (D.D.C. 1982 (citing H.R. Rep. No. 96-1418, 96th Cong., 2nd Sess. 9-10, 12, 18, reprinted in (1980) U.S. Code Cong. and Ad. News 4987-89, 4991, 4997). The costs of seeking justice through the adjudicatory process are in many cases prohibitively high for small businesses; precluding them from full recovery of their costs will necessarily decrease both their ability and their motivation to access the process to contest unreasonable agency action. *Cf. Photo Data*, 533 F. Supp. at 350, 351. HCNC believes that HUBZone small businesses will necessarily and inevitably perceive the outcome of the Court's holding to be particularly unfair to their class of enterprise. *See* Ralph C. Nash, *Interest on Claims: A New Wrinkle*, NASH & CIBINIC REPORT, March 2006 at ¶ 13 (observing that the *Richlin* decision "punishes the contractor for not having the financial resources to" to pay the back wages after the final decision entered years after the claim was filed).

As small businesses frequently participate in Federal contracting as subcontractors, the holding's undermining of the "pass-through" principle will further limit the ability of

such businesses to obtain vindication of their rights through the adjudicatory process.

As a result, the holding will have a chilling effect on HUBZone business participation—and likely other small business participation—in programs Congress has created pursuant to a policy of enabling and enhancing their access to Federal contracting opportunities. In sum, HCNC submits that the Panel's decision will have the unintended consequence of decreasing HUBZone business and likely other small business participation in Federal contracting – an outcome exactly opposite to that sought by Congressional small business policy.

CONCLUSION

For the foregoing reasons, *amici* respectfully urge that the Court grant the petitioner's writ of certiorari.

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